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IN THE

Supreme Court of the United States

October Term, 1940.

VALLEY WASTE MILLS,
Petitioner,

vs.

W. E. PAGE, JR.,
and
FIRST NATIONAL BANK OF ATLANTA,
Executors of the Estate of W. E. PAGE.

No. 614

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER.

MARION SMITH
LOUIS REGENSTEIN, JR.
HATTON LOVEJOY
Petitioner's Attorneys.

Marion Smith
Louis Regenstein, Jr.
1045 Hurt Bldg.
Atlanta, Ga.
Hatton Lovejoy
LaGrange, Ga.

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The response to the petition for certiorari, when analyzed, is in reality an appeal to the Court to do what the Circuit Court of Appeals did, namely, to dispose of the case by a narrow regard for the form which the transactions took, and with a complete disregard of the real substance of the matter.

This is shown by the Government's argument—its only argument—that taxpayer's position was changed by reason of these switching transactions because, the Government says,

the switching transactions made cash available to the taxpayer which had not been otherwise available. To sustain this the Government says that in each switching transaction, when the cotton was sold a credit to the taxpayer was entered on the books of the broker, subject to be withdrawn by it, and a new cotton purchase account was opened. There could be no more complete illustration than this of a narrow regard for form rather than substance. It reaches a climax when the Government says that before the switching transactions the taxpayer had cotton, and after the transactions the taxpayer had cotton and cash. This may be the way the matter appears from the standpoint of form; it is in no sense, however, the real substance of the situation.

Methods of trading in commodities for future delivery on established exchanges are so much a part of our economic life that they are undoubtedly within the judicial cognizance of the Court. Let us, therefore, state exactly what would occur, so far as available cash is concerned, in any such transactions. It is very simple, namely:

When the taxpayer entered into a contract for cotton the broker would buy the cotton, debit the taxpayer's account with the purchase price and credit the account with the amount put up as margin. The contract for the cotton would remain in the broker's name. If the cotton advanced in value the amount that the taxpayer could withdraw from the account in cash would depend wholly upon the extent to which the increased value of the cotton exceeded the required margins. Thus at the time of a switching transaction, when cotton had advanced in price the taxpayer would have a withdrawable amount of cash in the account. Now the switching transaction would not increase this amount of withdrawable cash at all. When the cotton was sold the taxpayer's account would be credited with the profit, a new debit would be made for the new purchase, which new debit obviously would be greater than the debit on the previous purchase by the exact

amount that cotton had increased in price; and this increase in the debit being thus based on the increased price of cotton, would be the exact equivalent of the credit given the taxpayer as a profit on the first purchase of cotton. Thus the net balance in the taxpayer's account (the new debit less the new credit) would be equal to the old debit before the switching transaction. The net status of the taxpayer's account would, therefore, be that he would have the same amount of the same kind of cotton, subject to the same net debit. He would be allowed to withdraw from the broker exactly the same amount of cash that he could have withdrawn before the switching transaction.

So long as any one dealing through a broker (stocks and commodities are here exactly alike) maintains an unchanged long position, his margin requirements, except for market fluctuations, will be the same. Any withdrawals of cash by him from the broker, with the long position unchanged, amount to nothing but advances by the broker against the increased value in his account.

Now in the instant case it makes no difference as to what method was taken in writing up these things on the books. The whole transaction could be combined in one account, or it could be separated into two accounts, which the broker set up or which the taxpayer set up. The net effect of the book-keeping taken as a whole would be exactly what we have stated. The substance of the transaction would be that the taxpayer's position remained unchanged. The proof is clear that it was intended to be unchanged; that the purchase and sale constituting a switching transaction were not intended to be separate transactions but part of one transaction to carry out a pre-determined plan to retain an unchanged position.

It thus appears clear that the statement in our petition for certiorari is completely confirmed by the Government's re-

sponse, namely: This case turns entirely on whether, in the particular matters, tax liability is to be determined by form or substance. The case, therefore, presents a wide departure from the established principle of this Court that substance should control in such matters. Such a departure is a matter of general importance. It should not be permitted to enter into our tax laws unless this Court is willing to give it its sanction. Even aside from the fact that commodity dealings of this character are very widespread in the country, the question is one inherently of sufficient importance to justify the grant of the writ.

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